

January 31, 2006

**Minutes Of The Meeting Of The
Treasury Borrowing Advisory Committee
Of The Bond Market Association
January 31, 2006**

The Committee convened in closed session at the Hay-Adams Hotel at 3:00 p.m. All Committee members were present. Assistant Secretary Emil Henry, Deputy Assistant Secretary James Clouse and Office of Debt Management Director Jeff Huther welcomed the Committee and gave them the charge.

The Committee addressed the first question in the Committee charge (attached) regarding the appropriate composition of Treasury's debt portfolio and how to further develop guidelines on portfolio composition. Director Huther presented a series of charts describing the Treasury's portfolio considerations and the characteristics of bill and coupon financing. Since 1977, bills as a percent of total Treasury debt outstanding have averaged approximately 26 percent; currently bills are 23 percent of total debt outstanding. Director Huther showed charts describing the composition of the Treasury's current portfolio, and a chart showing that historically bills carry lower interest rates on average than coupons, but higher interest cost volatility. Director Huther indicated that bill issuance provides the Treasury with greater flexibility and is used first to address short-term changes in the deficit.

One member of the Committee asked whether Treasury should be looking at the new cash raised through bills versus coupons rather than the percent of total debt outstanding. Director Huther indicated that Treasury looks at average maturity of debt outstanding and the average maturity of issuance, and that both measures are of interest.

One Committee member noted that Treasury issues bills in large part for flexibility, but that with the flatness of the yield curve, it should not cost Treasury to move further out the curve and that it would be prudent to do so in part to avoid rollover risk. Another Committee member noted that the number of Treasury auctions per year (which is currently higher than average, particularly in bills) and the number of available days to auction securities could be a real constraint. Other members noted that this was a constraint that Treasury could manage. One Committee member noted that, out of the list of portfolio considerations, the primary considerations are flexibility, interest cost and liquidity. The Committee agreed that the list of portfolio considerations shown in the chart were reasonable.

One Committee member asked if Treasury should be looking at the division between bills and coupons in the portfolio, or if Treasury should be focusing on the average maturity of the debt. The Committee member noted that the Treasury has large financing needs going forward (forecasted deficits), that there is unprecedented demand for longer-dated securities, but that the average maturity of the debt outstanding was near

its lowest level in twenty years. The Committee member noted that extending the average maturity of the debt may be advisable.

The Committee then discussed Treasury's rationale for not having a stated policy on the appropriate level for the average maturity of debt outstanding or a publicly stated ceiling or floor for this measure. Several Committee members suggested that Treasury should not set an explicit target or band for the average maturity of debt outstanding or for bills as a percent of debt outstanding. One Committee member noted that Treasury should only set explicit targets if they relate directly to the stated portfolio considerations such as lowest interest cost. Some Committee members noted that setting bands for an appropriate average maturity of debt would be arbitrary. One Committee member noted that having the list of portfolio considerations was a better option and that the importance of each consideration may change over time. Other Committee members suggested that having a target would generate speculation in the market about what actions Treasury might take if Treasury were nearing its targets.

One Committee member suggested that Treasury needs to do more analysis on its investor base as it has changed substantially over the past twenty years. The member suggested more work needs to be done on the depth of demand, particularly at the very short and long end of the curve.

The Committee then addressed the second question in the charge regarding the Committee's views on resumed issuance of the 30-year bond. The Committee was asked about the initial auction size for the bond, coupon cycles for the STRIPS market and the consequences of a commitment to both coupon cycles on bond issuance in future years. Director Huther showed charts depicting the amount of bonds currently held in stripped form. Several members of the Committee asked why Treasury would wait to fill out the May/November STRIPS rather than addressing the issue now. One Committee member noted the recent increase in stripping activity and the gap in maturities between 2031 and 2036, and suggested that having February/August and May/November STRIPS would make a more complete curve. Other Committee members noted that Treasury should look at both the principal and coupon STRIPS and that analyzing just principal STRIPS does not convey the full story. Other Committee members suggested that Treasury should address STRIPS as the bond program matures rather than making a decision immediately. Director Huther noted that Treasury would like to have as much flexibility as possible, while maintaining transparency with the market.

The Committee then moved to discussing the size of the February 30-year bond issue. Director Huther reminded the Committee that Treasury had stated they would be issuing \$20 to \$30 billion in a 30-year bond in 2006. The Committee had differing views on whether Treasury should consider issuing a larger or smaller first bond. Some Committee members suggested that a \$15 billion initial offering was on the large side and that Treasury should be more cautious with its first bond offering in five years. Members suggested that Treasury should ease back into the market because some market participants were concerned about the duration and risk at auction. Other Committee members argued for a larger first offering, arguing that there was large demand for the

30-year bond, particularly from the pension fund community, and that this demand should warrant a larger issue size. These members noted that even if the first auction was a bit “bumpy,” demand for the issue would most likely cause the issue to trade well going forward in the secondary market. They suggested that the marginal cost to Treasury was lower than the risk of having too small an issue, and having it tighten up and trade poorly in the market.

Next the Committee addressed the third question in the Committee charge regarding the relationship between the shape of the yield curve and the outlook for financial markets. One Committee member presented a series of charts discussing the shape of the Treasury yield curve and the impact on the housing market, insurance companies, banks and leveraged accounts. The charts showed that the general economic climate in 2006 should remain favorable and argued that the shape of the yield curve has less predictive power today than in the past. The presentation showed that consumers have been expanding their spending capacity by extracting wealth from their homes, and that the shape of the yield curve and level of rates has had an impact on this phenomenon. The presentation showed that financial institutions, such as insurance companies, banks and leveraged accounts were taking on more risk and that risk appetite was growing.

The Committee was asked if flat yield curve was indicative of a slowdown or a recession. Several Committee members agreed that the flattening yield curve may not be predicting a slowdown or recession, but that other factors, such as heavy demand for longer-dated securities, were helping create the curve flattening. Several Committee members agreed that the flat yield curve and low level of rates had increased risk appetite, as market participants sought out higher returns.

Finally, the Committee discussed its borrowing recommendations for the February refunding and the remaining financing for this quarter as well as the April – June quarter. Charts containing the Committee’s recommendations are attached. The Committee consensus was to recommend a \$15 billion 30-year issue, though the Committee chairman noted the differing views.

The meeting adjourned at 4:30 p.m.

The Committee reconvened at the Hay-Adams Hotel at 6:30 p.m. All the Committee members were present. The Chairman presented the Committee report to Assistant Secretary Henry. A brief discussion followed the Chairman's presentation but did not raise significant questions regarding the report's content.

The meeting adjourned at 6:45 p.m.

Jeff Huther
Director
Office of Debt Management
January 31, 2006

Certified by:

Ian Banwell, Chairman
Treasury Borrowing Advisory Committee
Of The Bond Market Association
January 31, 2006

Attachments:

Link to the Treasury Borrowing Advisory Committee discussion charts
[U.S. Treasury - Office of Domestic Finance](#)

**Treasury Borrowing Advisory Committee Quarterly Meeting
Committee Charge – January 31, 2006**

Bills/Coupon Composition

We seek to develop guidelines for the appropriate composition of Treasury's debt portfolio based on the share of the portfolio devoted to bills relative to coupon securities. We would like the Committee's views on charts that we present and Committee suggestions on how to further develop guidelines on portfolio composition.

30-Year Bond

We would like the Committee's views on resumed issuance of the 30-year bond; initial sizes, coupon cycles for the STRIPS market and the consequences of a commitment to both coupon cycles on bond issuance in future years.

Shape of the Yield Curve

The recent flattening of the yield curve has led to questions about the relationship between the shape of the yield curve and the outlook for financial markets. We would like the Committee's views on the relevance of curve shape, at current levels, on the financial markets and institutions.

Financing this Quarter

We would like the Committee's advice on the following:

- The composition of Treasury notes to refund approximately \$17.3 billion of privately held notes and bonds maturing on February 15, 2006.
- The composition of Treasury marketable financing for the remainder of the January– March quarter, including cash management bills.
- The composition of Treasury marketable financing for the April-June quarter.